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Policy and Foreign Direct Investment: Case Study of Thailand's Automotive Industry

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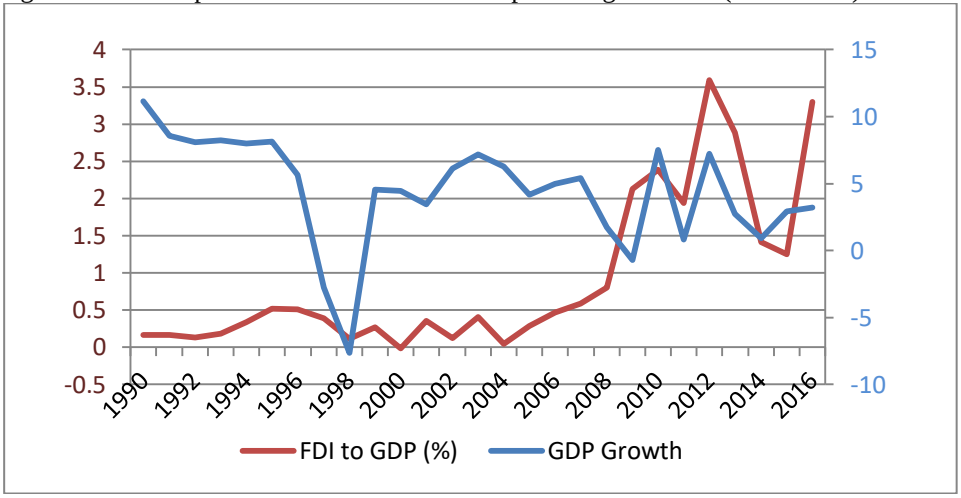
Abstract: Thailand's automotive industry has derived over the past 50 years, perpetually supported by government investment, taxation, and the promotion of foreign direct investment. However, the economic crisis (Tom Yam Kung) caused the worst downturn in Thailand. After the crisis, Thailand set policies to strengthen the potential of the automotive industry and implemented measures to promote the manufacture and utilisation of domestic automotive parts, such as an increase in import tax on Complete Built-Up (CBU) and Complete Knock-Down (CKD) to support foreign investment in Thailand's production base, such as exemption from corporate tax income and the import duty on machinery. Furthermore, the government determined an increasing requirement ratio for local content. Consequently, Thailand has the biggest production base in Southeast Asia; the first of its kind for pickup trucks in the world, and ranked twelfth for exports of automobile and automotive parts. Meanwhile, Thailand continues to develop its major goal to become a top ten exporter of the automotive industry in the world.

Keywords: Foreign Direct Investment, Industrial Policy, Thailand, Automotive Industry

Introduction

Foreign direct investment (FDI) is significant for economic development in developing countries. This is because the domestic savings are insufficient for investment. As a result, FDI is required, not only in the form of funds but also knowledge of technology, management, and intellectual capital which enhance competitiveness and accelerate the economy of Thailand.

Figure 1: GDP growth rate compared to FDI net inflows as a percentage of GDP (1990–2016)



Source: World Bank

The value of FDI in Thailand was 3.294% of GDP in 2016 (as shown in Figure 1) with the automotive industry receiving the most due to its importance in the development of the economy, employment, added value, and automotive technology. Income from the automotive industry accounted for 9% of GDP in 2016 (SCB, 2016). However, Thailand's automotive industry is different from that of other countries since no brands exist but Thailand has consistently

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improved free policies to attract foreign investment in the country's production.

International entrepreneurs of leading automobile and automotive parts have invested heavily in Thailand, with other countries implementing policies and measures to attract FDI. In consequence, the investment base has changed, resulting in fluctuations. Moreover, FDI fluctuation might affect employment in the domestic consumption and export sectors as well as and GDP. Ultimately, the automotive industry has been severely affected leading to recession and, importantly, changes in the structure of the automotive industry and related policies.

This research examines the foreign investment policies of the automotive industry as the main industry in Thailand, and the government measures relating to its development from past to present. Moreover, how it influences the automotive industry, problems experienced during the economic crisis in Thailand, and the future of the country. This will help to guide policy and planning to promote and attract foreign investment in Thailand and maintain appropriate foreign investment rates.

Thailand's policy for automotive industry development

The automotive industry in Thailand has been promoted and supported by the government since 1961. Initially, the purpose was to provide an industry to substitute imports and transport technology. The automotive industry is currently the highest exporter, earning 27,217 million USD per year (Trade Map, 2018). Besides, Thai automotive parts are accepted for their quality worldwide. Policy has evolved over time as follows.

Phase 1 (1961–1970): This marked the beginning of automobile assembly in Thailand which was Completely Knocked Down (CKD). The government set a policy for reducing import tax on automotive parts and reducing the business tax by 50%.

Phase 2 (1971–1990): This represents a period of growth for the automotive industry, resulting in a trade deficit since Thailand had to import complete parts for assembly. Thus, the Ministry of Industry announced the first automotive industrial policy requiring automobile assembly factories to use 50% of their automotive parts from manufacturers in Thailand and suppressed the establishment of new plants for five years. In addition, there was an increase in import tariffs for Complete Built-Up (CBU) and prohibition on the import of some CBU manufacturing in Thailand.

Phase 3 (1991–1997 prior to the economic crisis): During this time Thailand opened up the automotive industry to promote exports. The government abolished the policy for controlling the import of automobiles and the liberal policy for automobile assembly factories to comply with their obligations to the World Trade Organization (WTO).

After the economic crisis period (1997), the automobile sales volume decreased 50% following depreciation of the baht and the recession from 1997–1998, which affected the entire industry system, particularly regarding liquidity. As a result, the government implemented a free investment policy whereby foreigners could be majority shareholders in order to resolve the business liquidity problem and withdrew the requirement regarding the use of parts only manufactured in Thailand.

Currently, the vision of Thailand's automotive industry is "Thailand is a global green automotive production base with strong domestic supply chains which create high value added for the country, *environmentally friendly with international standards."* Thailand aims to be the production base for environmentally friendly automobile and automotive parts, while supporting the utilisation of modern environmentally friendly automobiles by implementing a tax exemption policy for battery electric vehicles (BEVs) and customs duty for battery parts and motors; the key to modern motor vehicle function (HEV, PHEV, BEV, FCV).

Foreign direct investment in Thailand's automotive industry

Since Thailand's automotive industry is different from that of other countries as it does not manufacture vehicles under a Thai brand and all vehicles are foreign, the automotive industry relies on foreign investment. In 1997, there was a bubble economy and the government announced the depreciation of the baht, leading to the Tom Yum Kung crisis. The automotive industry was in crisis so the government implemented a policy to encourage foreign investment with the aim of reviving the economic system and building an important investment base in the region.

Pattern of foreign direct investment

Foreign direct investment or FDI refers to investors or companies making an investment in a business to produce products or services in another country aiming to control the asset administration or business. The investment may be via money transfer to another country or foreign investment from outside sources.

The Bank of Thailand defines FDI as the transactions by an investor based in one country making an

investment in another country and comprises three types of investment as follows.

Equity capital means an investment holding of more than 10% of the business or having the right to administer business or loans from the parent company or its affiliates. However, there is an exception for finance companies and finance and securities companies which are considered to be other loans. Reinvested earnings are revenue in the form of dividends for the direct investor as shareholdings in the enterprise or earnings of the branch that do not return to the investor.

Moreover, the United Nations Conference on Trade and Development (UNCTAD) classifies the type and qualifications of FDI as follows.
1) Greenfield investment is a new business set up from scratch with FDI.
2) Reinvested earnings are the profits invested in the country rather than being returned to the investor.
3) Intra-company loans are loans from the parent company in the country or an affiliate company outside the terminal country under the condition of time and return.
4) Mergers and acquisitions relate to a company merging with or being acquired by a foreign company in the same or related industry.
5) Non-equity forms of FDI have concessions such as subcontracting, licensing for intellectual property, or franchising.

Geographical origin of foreign direct investment

In 2017, foreign direct investment in Thailand was 2,826.96 million USD, increasing by 12% from 2016. Japan invested in Thailand the most at 1,330 million USD, followed by Singapore and the USA, at 403 and 275 million USD, respectively (as shown in Table 1).

Table 1: Top 10 Foreign Direct Investment from Major Countries (2017)

(Million USD)

Country	2017	
	No.	Invest.
Total Foreign Investment	**818**	**2,826.96**
Japan	256	1,330.02
Singapore	88	403.66
RPC (China)	87	275.14
USA	33	200.22
Netherlands	28	158.42
Taiwan	49	90.36
Malaysia	22	82.35
Hong Kong	41	71.56
Indonesia	5	62.10
Australia	15	45.50

Source: Thai BOI

The top three industries receiving FDI in Thailand were automotive and parts (730.58 million USD), electronics (437.52 million USD), and petrochemical and chemicals (269.88 million USD) (Thai BOI, 2018).

In summary, the FDI from Japan was 47% of the total (Thailand Business News, 2018). Japan made the largest investment in Thailand's automobile production base. Most investments were for large-scale projects such as automobile production, landing gear production, and tyre production. Additionally, Japan has expanded its projects currently based in Thailand because it has policies for attracting foreign investors, labour potential, and importantly, is the centre of the ASEAN which attracts a great deal of foreign investment.

The contribution of foreign direct investment to the automotive industry

Investment in Thailand's automotive industry during the first phase was mainly from moving the production base of Japanese companies in order to reduce production costs and European and American automobile companies followed. The investment values of automobile companies are shown in Table 2.

Table 2: Investment by foreign automobile companies

Company	Investment (Million USD)
MMC Sittipol	238.65
Honda Automobile	101.44
Siam V.M.C. Automobile	28.12
Toyota Motor	327.27
Auto Alliance	352.19
General Motors	639.84
Auto Alliance	26.41
BMW Manufacturing	34.27
Hino Motors	21.33
Fiat Auto	11.78
Siam Nissan Automobile	185.93

Source: Thai BOI

It was obvious that the leading automobile companies in the world made the investment on production base in Thailand which activated and attracted the investment in Thailand automotive parts production from domestic and foreign investment to manufacture automotive parts for these manufacturers.

Since the economic crisis, investment in the automotive industry has constantly expanded, mainly in the automotive parts production business, in order to support the large automobile companies establishing plants in Thailand.

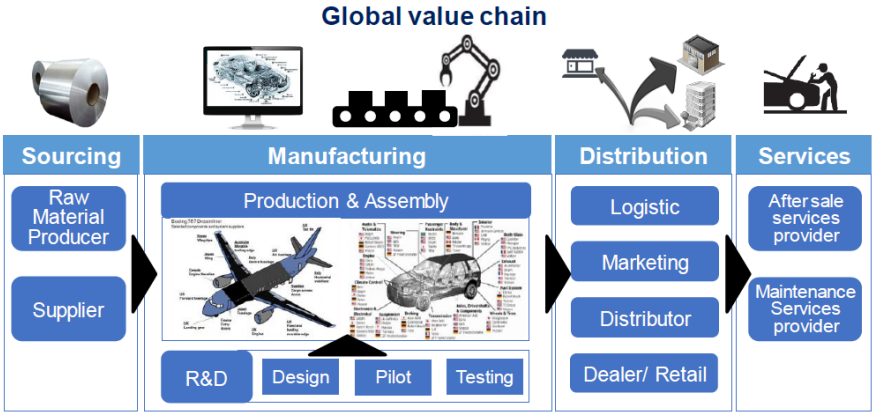
In short, the large-scale investment came from transnational companies in parts production companies under the brand of each automobile manufacturer known as tier 1. Most Thai entrepreneurial investments were in tiers 2 and 3, which produced parts for the automotive manufacturers in tier 1. Investment in the automotive parts production business is likely to grow in the near future as regional markets tend to expand, and this might affect automobile companies with the production of more vehicles and increase demand for automotive parts. However, the trend for investment in the automotive industry in the next 5–10 years showed a positive direction so a number of automobile companies were ready to expand their production base in Thailand and increase the investment in the industry. In 2017, the investment value of the automotive industry in Thailand was 524.41 billion USD (Thai BOI, 2017) with most investors being tier 1 automobile manufacturers. Thai entrepreneurs mostly supported automotive parts for manufacturers in tier 1.

Evolving policies towards Thailand 4.0

"Thailand 4.0" is the vision policy for Thailand's economic development model for 2017–2037, which will change the Thai economic structure to a "value-based economy" driven by innovation. The government has set a development and investment promotion policy for the ten industries expected to become the future industrial base, and upgrade potential industries in Thailand to add value from innovation, particularly in the five major industries: automotive, agricultural and food, tourism, electronics, and petrochemical.

For Thailand 4.0, the industrial policy for the automotive and parts industry is set to have exemptions for importing vehicles functioning by motor (BEVs), with the customs duty for battery parts and motors for modern vehicle functioning (HEV, PHEV, BEV, FCV). Furthermore, a special excise tax has been set for hybrid and plug-in hybrid cars, decreasing 50% from the normal rate, while for electric cars functioning by battery it has been reduced from 10 to 2%. Regarding the policy for attracting foreign investment, Thailand has connected the automotive and parts industry to the global value chain of the main industries (as shown in Figure 2) to allow outward investment credit and outward investment soft loans to attract foreign investment.

Figure 2: Promotion to connect Thai industries in the global production chain



Source: Ministry of Industry

Thailand could be seen as the vehicle production country; the "Detroit of Asia" and one of the world's largest automobile exporters. Hence, keeping up-to-date with developing automotive technology is vital. When the future world automobile trend changed towards electric vehicles, Thailand started building the foundation to manufacture electric automobiles. Therefore, the development policy approach to Thailand 4.0 changed to promote immediate investment, foster entrepreneurs to invest in electric cars, and the manufacture of electric automobiles. Moreover, the government has promoted the manufacture of Eco-car and Eco-car 2.

Implications

The objective of Thailand's trade and investment policy is aimed at enhancing and stabilising the automotive industry as the primary industry to attract foreign investors. However, with the free economy and economic integration, Thailand needs to compete with other countries to maintain trust from foreign investors and strengthen government policy for the automotive industry. Nevertheless, policies and other problems inevitably impact on industries and affect foreign investment.

Moving and expanding the production base to other countries

The crisis in the automotive industry forced the automobile companies to alter their strategies; one of which was to adjust investment plans to enhance the production potential and market products by selecting a production base and appropriate marketing strategies. Thailand, as an investment base, has definitely had an effect; although Japanese automobile companies expanded their investment in Thailand, they also accelerated investment in Vietnam as well.

The amount of direct investment from Japan to Vietnam's automotive industry has shown constant and rapid expansion. Although the Vietnamese automotive industry has not been developed to the same standard as Thailand because of a lack of preparation in the relevant industries and basic utilities, the lower labour cost and the larger market trend are interesting factors for attracting direct investment in the automotive industry. Besides, Vietnam has attempted to improve its public utility systems, creating the possibility of it becoming an important automobile manufacturer in the region, even though there is currently a high rate of imports in complete and semi-complete parts. With such a trend, there is a chance it will impact on the automotive industry in the future if Thailand fails to plan appropriately, particularly concerning the benefits of investment, physical infrastructure development, knowledge base and personnel, as well as political stability under changes in the global automotive industry structure. As investors, foreign automobile companies are likely to select the production base which provides the greatest benefits. As the country and its automotive industry receiving the funding are the main targets for national development, Thailand should strengthen its attraction in order to retain foreign investment.

Trans-Pacific Partnership (TPP) Non-attendance

The strength of Thailand is crucial to investment sources in the region. Thus, there is strong integration in automotive industry demand and superior skilled labour to the neighbouring countries. In considering the influences of TPP on Thailand's automotive industry the impacts of the US market must be analysed in the context of the large consumer market in Thailand.

The value of automobile and automotive parts imported by the USA in 2017 illustrates that the import of automobile parts is concentrated in the TPP member countries: Canada, Mexico, and Japan, which have low import ratios from Thailand. However, this does not mean that the low import

scale of the USA is meaningless in the context of exports to Thailand.

Considering the structure of complete-automobile exports from Thailand to the USA, the value of passenger cars imported to the USA was ranked in the top ten, or 1,319.30 million USD. However, for TPP to be effective, the short-term effects on automobile and automotive parts exported to the USA market are limited for two main reasons:

1. The import tax from Thailand is low; the MFN rate for passenger cars is 2.5%, whereas Thailand's automotive parts had the privilege of GSP from the USA where the import tax rate is 0-2.5%.

2. A substitute market for passenger cars and automotive parts cannot be achieved immediately. Each automobile manufacturer in the world has a production base proficient in producing a specific model so the change in imports of some models or parts cannot be processed promptly. The USA imported most parts from TPP member countries such as Canada, Japan, and Mexico (60%) while some were imported from non-member countries such as South Korea, Japan, and Mexico, around 23% (0.5% from Thailand). Changes in the sources of automotive parts from TPP non-member countries to member countries is unlikely to happen quickly as some part types are not produced by member countries such as Vietnam, Malaysia, or Singapore. In the long term, not being a member of TPP, Thailand has gained less interest as an investment source which has incentivised the FDI to seek other member countries such as Vietnam or Indonesia who have expressed a strong intention to join TPP. This would have a great effect on Thailand's automotive industry in the CBU sector which unavoidably relies on foreign investment and technology and automotive parts, especially during the transition period towards the electric car.

Ongoing political problem

FDI is a long-term investment because of the need for plants to be established, machinery imported, and loans for investment purposes. Therefore, such planning takes time. For this reason, the ongoing political problem might not immediately affect investment but could impact on investor trust in the long term; new or current investors who are increasing the scale of their investment may lose confidence as they are worried about political problems affecting their business. According to this concern, some scholars expressed their perspective that it would have a great effect on the foreign investment directly. Ongoing political problems may influence foreign investors to delay their investment in Thailand or invest in other countries in the ASEAN. Such investment in Thailand is valued at more than two-hundred thousand million baht, and this may consequently decrease considerably ("Cross-over year politic 'moving investment base'", 2014). This is in line with the suggestion that Japanese investors slowed down their investment in Thailand. However, since the political situation continued for more than three months, the investment plan for Thailand would be reviewed (Supawut Saichue, 2016).

Conclusion

FDI is significant to the development of developing countries as domestic savings are insufficient for the investment demand. Foreign investment offers benefits to both investors and receivers because when investment is increased or moved to another country, entrepreneurs are able to take advantage of the resources in that country to enhance the competitiveness potential and company profits while receivers gain benefits from an increase in GDP and new technology for industry development. In Thailand, the automotive and automotive parts industry receives the most foreign investment and has a rapid growth rate. Furthermore, value added in this industry is low due to the technology development requirements of Thai automotive parts manufacturers by Japanese customers. Thus, most Thai manufacturers are only ranked second or secondary manufacturers. At the same time, the highest ranked Thai manufacturers signed a contract to implement production technology from Japan.

Therefore, the policy for investment promotion should not only aim to increase the value of the industry but emphasise the development of infrastructure, especially regarding technology transfer from foreign investors which is the most advantageous for industry development in the invested country. The factors of greater importance than policy are infrastructure and public utilities, environmental factors in the labour market, communication infrastructure, economic stability, and trade policy of the invested country to attract investment (Holger Görg and David Greenaway, 2003). Hence, Thailand should increase its policy to maintain country stability while constantly attracting further investment. Moreover, measures relevant to technology received from investors should be implemented in order to provide the greatest benefit to Thai people.

Suggestions

Crucially, competition for investment in the region is increasing and the government and relevant agencies currently give priority to seeking and attracting more investment in Thailand's automotive industry in order to avoid a future loss of investment opportunity to neighbouring countries. The most urgent matter on which the government or policy practitioners should take action is strengthening Thailand in diverse aspects such as personnel skills and supporting

potential industry development, especially technology for future high standard automobile production and focus on energy-saving and the use of alternative energy to substitute the high cost of labour and materials, maintaining products of an acceptable quality, and removing the weak points, particularly regarding political instability that could gradually destroy the trust of investors. Furthermore, policy implementation clarity in the long term between automotive industry development and the direction of energy should be considered. Additionally, the government and relevant agencies should seek opportunities for investment in Thailand's automotive industry; implementing measures for investment promotion to facilitate the interest in investment, investment in business sector production, and co-operating with the exploration of potential markets as well as supporting free trade agreements in competitive countries. All these factors are expected to increase potential investment in Thailand. In addition, apart from strengthening and eliminating weak points, the most important matter that cannot be overlooked is that the government and concerned agencies should co-operate in building trust for investors and be ready to support them in achieving success, while creating a long-term positive image for investors as the country most suitable for investment in the future.

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